

# THE SOCIAL IMPACT OF MICROFINANCE

edited by

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## INTRODUCTION

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**Abstract:** Analysis of the poverty impacts of microfinance is almost exclusively focused on the direct impacts on microfinance clients. The *Imp-Act* programme emphasizes the need to also consider the ‘wider impacts’ achieved through non-client beneficiaries of microfinance. To fully understand and achieve the social impacts to which microfinance aspires wider impacts need to be assessed and programmes designed to achieve these outcomes. This volume introduces methodologies, in most cases developed by practitioners, which measure these wider or ‘social’ impacts and use the results as a point of departure for understanding what institutional and policy interventions are required to make them more pro-poor. The principal wider impacts discussed are health, community governance, postwar reconstruction, labour and finance markets and, in relation to Bolivia and Indonesia, the economy as a whole. We represent research into such wider impacts as a public good which is beneficial for all microfinance institutions (MFIs)—in particular for their public relations—and for the poverty impact of the sector as a whole, but which the individual institutions typically do not have the resources to assess. This indicates a clear role for donors. Copyright © 2004 John Wiley & Sons, Ltd.

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## 1 OBJECTIVES

Initiated as a simple ruse to keep Bangladeshi market-women out of the clutches of the moneylender, microfinance has evolved into one of the twentieth century’s most radical innovations in development policy and practice.<sup>1</sup> It has spread into almost every country, including a number of industrialized nations. In all of those countries, it has been given a

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<sup>1</sup>Although microfinance as it is practised now was first experimented in the 1970s by BRAC, Grameen and others, lending for alleviating poverty was used in South Asia at least a half-century earlier by Rabinranath Tagore, the Nobel-laureate poet. To help his subjects (Tagore was a landlord) he promoted and organized co-operatives of poor villagers and provided loans to them for income-generating activities (Mukherjee, 1998).

leading role in the fight against poverty, and it has been charged by one pressure group, the Microcredit Summit, with the task of halving global poverty within ten years.<sup>2</sup> No wonder, in a way, since in relation to nearly all the major causes and indicators of development—education, health, population control, women's well-being and solidarity, community-building, democratic participation, technical change, expansion of labour markets, even HIV/AIDS—there exists evidence that microfinance is capable of improving matters.<sup>3</sup> For international financial institutions, policy-makers and local community activists alike, the temptation to treat it as a magic potion which will heal any of the afflictions of poverty is hard to resist. In China, for example, a UNICEF-supported programme in 12 of its poorest provinces uses microcredit as a 'conduit' to achieve wider social development goals (Chowdhury *et al.*, 2001).

Despite this evidence, there is growing recognition and evidence from the work of the *Imp-Act* programme<sup>4</sup> that these impacts are not automatic and are dependent on the precise objectives, design and wider operating environment of individual organizations. Considerable debate remains about the effectiveness of microfinance as a device for directly reducing the poverty of *clients*, and whether benefits differ according to the characteristics of clients—for example, poverty level. A number of studies question the ability of microfinance to effectively reach clients significantly below the poverty line or suggest that poverty impacts may be grater for non-poor than for poor clients (Hulme and Mosley, 1996; Sebstad and Cohen, 2001; Mosley and Rock, 2004). Whether this reflects an inherent inability of standard microfinance models to reach and impact on very poor clients, or a bias in the design and management of microfinance institutions towards better-off clients is the subject of debate.<sup>5</sup> In addition, as discussed in Mosley and Rock (this issue) the definition of poverty used may have considerable bearing on the conclusions reached about poverty impact—for example reduction of risk and vulnerability for very poor clients may be significant even where absolute income changes measured are small. The experience that microfinance typically does not reach clients well below the poverty line has led to a renewed effort to deepen the poverty outreach of microfinance, reflected for example in the rise of savings-based microfinance products (Dowla and Alamgir, 2003). However, the ability of microfinance to create significant impact on poverty is constrained by the failure of many organisations to achieve the depth of outreach hoped for. Increasing the capacity of MFIs to work effectively with very poor and excluded people and achieve a positive impact on them forms an important focus for the work of

<sup>2</sup>For critiques of this target see Rogaly (1996) and Mosley and Hulme (1998).

<sup>3</sup>For a detailed literature review of the effects of microfinance on poverty see Morduch and Haley (2001). In addition, for education see Khandker (1998); for health see Chowdhury and Bhuiya (this issue); for population control, Schuler and Hashemi (1994); for women's welfare, many sources but notably Kabeer (2001); for community building and democratic participation, Olejarov *et al.* (this issue) for technical change, Hulme and Mosley (1996); for labour markets, Mosley and Rock (this issue) for HIV/AIDS, Kenya Rural Enterprise Programme (2001).

<sup>4</sup>*Imp-Act* is a global action research programme designed to improve the quality of microfinance services and their effect on poverty. *Imp-Act* works with 30 partner MFIs to develop credible and useful impact assessment systems based on the priorities of the organisation and their clients. These systems provide information useful for improving both social and financial performance and provides externally credible information on an MFI's social performance. *Imp-Act* is also working to improve understanding of how MFIs can sustainably work with very poor and excluded people, and to take into consideration wider impacts, beyond those on individual clients or their families. *Imp-Act* is jointly implemented by a team from three UK universities (IDS Sussex, Bath and Sheffield). *Imp-Act* was initiated and is funded by the Ford Foundation.

<sup>5</sup>See for example Simanowitz with Walter (2002).

the *Imp-Act* programme. Through improved understanding of their clients MFIs are able to modify their programmes and expand the range of possibilities for poverty outreach and impact. A core focus of the work of *Imp-Act* partners is thus to strengthen the *direct* impact of microfinance, by developing a 'range of instruments which, it may be hoped, might be able to increase the poverty impact of microfinance' (Mosley and Rock, this issue).

This is not the end of the story, precisely because of the fact that the impacts of microfinance extend far more widely than the individual client, and there is reason to believe that some of these 'wider impacts'<sup>6</sup> may well be poverty-reducing, when poverty is seen as a phenomenon reflecting many disadvantages (Chowdhury and Alam, 1998). However, not many of them have been measured. Of the possible effects catalogued above, health and education spillovers have been particularly well covered by Khandker *et al.* (1995, 1996, 1998). But on labour markets, capital markets, social capital and participation, conflict, and the macroeconomy, the record is virtually silent. The reason is not far to seek: the assessment of these impacts is complex and resource-intensive, and the profit motive provides no incentive to monitor them. Nor does the literature of the so-called 'second microfinance revolution' (Woller, 2002), which argues for a sharper focus on the client rather than the provider of microfinance. The gap between clients and the beneficiaries is wide, and although the voices of clients are heard through the market, the voices of other beneficiaries are not. It is important, if microfinance is to fulfil the social mission to which it aspires, to know the extent to which its wider impacts contribute to poverty reduction. The major purpose of this collection of articles is to assess whether that hope has been fulfilled—or at least to indicate methods by which such an assessment can be done—and on that basis to indicate policies which hold out hope of enhancing poverty impact in general.

We seek here, therefore, to enable the voices of *non-client beneficiaries* to be heard—both in relation to impacts which have been widely documented, such as health (Chowdhury and Bhuiya, this issue), and in relation to ones which have not previously been much assessed, such as those relating to political participation (Olejarova *et al.*, this issue) reconstruction (Tsilikounas, this issue), labour markets (Mosley and Rock, this issue), capital markets (Johnson, this issue) and macro-economic impacts (Velasco and Marconi, this issue). Our main story, then, is that a better understanding of these wider impacts can help microfinance institutions, and those who sponsor and assist them, to reduce global poverty, broadly defined. However, this is not remotely to suggest that more cannot be done by the alternative route of targeting the poorest more precisely, and at the same time exercising creativity in the design of financial instruments which can reach them effectively. BRAC of Bangladesh has been a leader in the design of such instruments, and, Halder and Mosley (this issue) examine BRAC's scheme for Income Generation for Vulnerable Groups Development (IGVGD), a pioneering methodology for bringing financial services to ultra-poor clients.

Most of the essays in this collection derive in whole or in part from work conducted under the *IMP-ACT* programme on impact assessment of microfinance, financed by the Ford Foundation. *IMP-ACT* seeks to improve the quality of microfinance services and their impact on poverty by working to develop reliable and useful impact assessment systems

<sup>6</sup>From this point on, we use the phrase 'wider impacts' to mean effects which are experienced by individuals other than clients. They are thus equivalent to the *externalities* of welfare economics.

based on the priorities of MFIs and their stakeholders, and by understanding the process (and improving the extent) to which microfinance reduces poverty. The relevance of the 'wider impacts' theme to these objectives will be clear, and several of the papers presented here (Zohir and Matin; Khalily; Chowdhury and Bhuiya; Johnson) are derived from a conference on Wider Impacts of Microfinance hosted by BRAC at Rajendrapur, Bangladesh, between 5 and 8 January 2002. But the objectives of this collection extend beyond this—we are interested not only in methodology and measurement of such impacts, but also in constructing incentives for them to be measured by the organizations which create them. A key proposition which we wish to advance is that all NGOs that exist for other reasons than profit, can maximise their effectiveness by learning, and publishing, what they are achieving on behalf of all their beneficiaries, and not just those formally designated as their clients. At present they do not do this; we hope this volume, co-edited by one of those MFIs and embodying the experience of several others, will help them get there.

One symposium of papers from the IMPACT programme has already been published (Brody *et al.*, 2003). This dealt broadly with the three areas of focus of the programme—understanding the nature and mechanisms by which microfinance impacts on poverty in different contexts and from different approaches, looking at how information can be generated and used to allow MFIs to better manage their 'social performance' and design methodologies that are better targeted and segmented towards desired target groups, and achieve outcomes and impacts as determined by the organisation's social objectives and mission; and a consideration of the nature of wider social and economic impacts of microfinance and how these can be assessed. This volume looks in more detail at the issue of social impact.

## 2 NEW RESULTS AND IDEAS

### 2.1 Measurement of New 'Wider Impacts'

In this collection, then, we pursue the Ford Foundation's objective of seeking to understand and internalize processes by which microfinance influences social well-being, but with a focus on *social* or *wider* impacts which go beyond the immediate client, and on methodologies which may enable these impacts to be more accurately measured. As illustrated in Table 1 below, all the essays in the second part of the volume seek to address wider impacts of one kind or another. In some cases (income, health, poverty), attempts to measure the impact in question have already been made in the literature, but as far as we are aware, Olejarova *et al.*, this issue (on social capital and political participation) Tsilikounas, this issue (on reconstruction) Johnson, this issue (on local financial markets) and Velasco and Marconi, this issue (on macro-economic impact) are the first to produce impact results in their chosen fields in a formal way.

In many ways, the results of these enquiries into wider impact give grounds for encouragement. Halder and Mosley, Mosley and Rock, and Velasco and Marconi, this issue, in particular, produce evidence of indirect impacts of microfinance on poverty. These operate through the following mechanisms:

- *Institutional inspiration* (Halder and Mosley, this issue)—the innovative IGVGD scheme of financial services for the ultra-poor in Bangladesh (food aid, then a combination of mandatory savings and training in a low-input enterprise, then a small loan to support that enterprise) has provided ideas at no cost to other MFIs in Bangladesh and elsewhere wishing also to focus on the ultra-poor;

Table 1. Functional classification of the studies in this volume

	Mainly quantitative methods	Mainly qualitative methods	Both qualitative and quantitative methods	Remarks on causation, etc
<i>Client-based or 'narrow'</i>				
Income/physical Assets/poverty			Halder and Mosley, this issue (Bangladesh)	
Human capital/ education/health	Chowdhury and Bhuiya, this issue (Bangladesh)			
Gender/empowerment/ intra-household relations		Tsilikounas, this issue (Bosnia) Johnson, this issue (Bolivia)		
<i>A wider frame of reference than the client or 'wider'</i>				
Income/poverty/ physical assets			Mosley and Rock, this issue (various African countries) Halder and Mosley, this issue (Bangladesh) Olejarova <i>et al.</i> , this issue (Russia and eastern Europe)	Measured impact depends on poverty definition chosen
Community-building, 'social capital' accumulation and political participation			Tsilikounas, this issue (Bosnia)	Focus on postwar reconstruction
Employment/labour markets		Mosley and Rock, this issue (various African countries)		
Interest rates/capital markets		Johnson, this issue (Kenya)		
Macro economic impacts	Velasco and Marconi, this issue (Bolivia)			

- *Encouragement of participation in community solidarity networks and political activities, or 'social spillovers'*—this can take many forms.<sup>7</sup> Olejarova *et al.* (this issue) examine, in Russia and eastern Europe, the process by which mutual support between microfinance clients—which may or may not originate in trust groups of loan recipients—can extend outside the group of clients in terms of both membership and function, so that, for example, a group formed to receive loans finds itself also campaigning collectively for better public services or fighting local-level corruption—in the process benefiting many who are not microfinance clients. It is also possible for

<sup>7</sup>It is these social spillovers which tend to be of particular importance in the context of industrialised countries where the main target group for microfinance has been the financially excluded in decayed inner-city areas where unemployment and crime are high and access to bank branches is not easy (Mosley and Steel, 2003a; 2003b). If microfinance loans make such inner-city environments a more attractive place to invest in (for example by improving the housing stock, improving landscape, or reducing local unemployment), they will generate spillovers well outside the client group into the entire population of such environments—possibly, in the process, reducing crime and drug-addiction rates in such areas.

microfinance services which have a protectional function, for example savings and insurance, to stabilise income at the community level, and the beneficiaries from this will be not just clients, but all investors who face a more stable level of demand (see for example Mosley, 2003);

- *Derived demand and other economic spillovers* (Mosley and Rock, this issue)—labour market impacts—specifically the hiring of poor employees by microfinance clients who are generally above the poverty line —add an important ‘multiplier’ to direct impacts mediated through clients, whose size depends on the propensity of loan-assisted firms to take on low-income labour;
- *Provision of public goods, in particular counter-cyclical influence* (Velasco and Marconi, this issue). A few microfinance institutions—in Bolivia, mainly those using an ‘integrated’ model of microfinance service provision—have been able to assist microenterprises to maintain an increased level of output and investment through the recession, and in this way to lead the macroeconomy out of recession and provide a buffer against the continuing instabilities in the global economy. This is the ‘widest impact’ of all, and has potentially significant implications for finance industries as well as for regulators and lending institutions; but it appears, for reasons explained in Marconi and Velasco’s essay, to vary between country cases—countries with a stronger savings and manufacturing base, and tougher political defences against would-be defaulters, such as Indonesia, would appear to be in a better position for their microfinance sectors to provide a counter-cyclical impulse. But there are institutional design factors at work as well, and for philanthropic MFIs one of the pleasantest ironies of this volume will be that in the recent Bolivian economic crisis, it is the financial institutions most driven by a naked profit motive—the consumer-credit houses—which have perished, and those motivated to live by a law beyond that of the market (in other words, to maximise ‘wider impacts’)—the village banks—which have prospered.

However, not all the wider impacts discovered are at all expected. Olejarova *et al.*, this issue show most impacts of microfinance on political activity are on *informal* participation—lobbying, demonstrating and taking part in the activities of pressure-groups—rather than, as foreseen, on formal activities such as voting. Velasco and Marconi, this issue find that the entry of the aforementioned consumer credit houses into microcredit in Bolivia, so far from broadening the range of choice, has achieved the negative ‘wider impact’ of destabilising loan discipline and the entire bottom end of the financial system. By contrast, Johnson (this issue) finds that the biter has been bit—that in Kenya, consumer credit and commercial banks have competed successfully with microfinance, forced it upmarket and possibly damaged its claim to comparative advantage in accessing the poor and underprivileged.

In the discussion of this part of the volume we indicate the possibility of other more ambitious wider impacts of microfinance, not yet properly researched. For example, the apparent ability of microfinance, in Russia and Eastern Europe, to achieve greater participation in political processes (mainly informal processes, on the strength of our analysis in Olejarova *et al.*, this issue) may have helped to protect and nurture what in many of those countries is a very vulnerable and nascent democratic process. And it may also be that microfinance is able to impinge on the margin between conflict and peace: not only on *intrahousehold* violence through its empowerment of women (Schuler and Hashemi 1994; Chowdhury and Bhuiya, 2001a) but also to contribute to peace in a much broader way, precisely by reducing poverty and building social capital.



All of this adds up to a picture of the social impact of microfinance, and of the policies required to sustain it, rather different from that projected by the current literature. For whereas, in most versions of that literature, the development of microfinance can be optimised by paying maximum attention to the needs of the *client* (e.g. Woller (2002), and the essays contained therein), our own approach would require also the consideration of the needs of beneficiaries who, to the extent that there are 'wider impacts', are different from clients, and sometimes have conflicting interests. (For example, as illustrated in Mosley and Rock, this issue, in certain circumstances a policy of targeting low-income *borrowers* may reduce the labour demand coefficient and thus not be in the interests of poor *workers*.) The enlargement of wider impacts may, in many cases, be needed to achieve a serious poverty impact for the institution; and, as argued above, it may often be the indirect beneficiaries rather the direct clients who have to be focussed on if microfinance is to live up to its billing as a serious vehicle for poverty reduction.

## 2.2 Methodology

By contrast, the first four articles are concerned with methodologies for impact assessment, again with an emphasis on wider impacts. Zohir and Matin establish a taxonomy of wider impacts, and in particular distinguishes between the measurement of first-round impacts and the assessment of the 'second-stage' impacts which arise after the first-round effects have been fed back into financial institutions (the assessment of such feedbacks is a major objective of the IMP-ACT programme). The third article by Khalily is a creative reflection on the tradition of mainly quantitative impact assessment in Bangladesh, which began with the massive World Bank—sponsored econometric study by Khandker, Pitt *et al.* (known in Bangladesh as the 'mother of all surveys'; see for example Khandker 1998) and has contributed enormously to our understanding of a number of the wider impacts of microfinance, notably those affecting personal and reproductive health, education, and intrahousehold relations including the incidence of domestic violence. But the mother of all surveys cost \$700,000, and thus cannot be replicated by ordinary microfinance institutions wishing to understand their own wider impacts. Copestake and Wrigh offer a tool which potentially can cut the cost of impact assessment while retaining rigour: the QUIP or 'qualitative impact protocol'.

As Copestake and Wright argue, 'different types of evaluation tool produce different results'. To quote a celebrated example from Bangladesh, Naila Kabeer (2001) found that the impact measures of microfinance on women's empowerment derived from qualitative *process* approaches (which asked women clients questions such as 'Do you feel that your control over the management of the household business has increased since taking your loan?') were much more pessimistic than those derived from mainly quantitative *outcome* approaches (which examine changes in expenditures over which women had control). One of the refreshing developments in impact assessment generally in recent years, not only in microfinance, has been the development of so-called '*Q-squared*' methodologies which combine qualitative and quantitative approaches, and Halder and Mosley; Olejarova *et al.*; Tsilikounas; Mosley and Rock; and Johnson, this issue in this volume utilize this kind of combined methodology.<sup>8</sup>

<sup>8</sup>Chowdhury and Bhuiya (this issue) present data from a bigger study done over the decade of the 1990s which also used an integrated framework encompassing both qualitative and quantitative methods. The other impact assessment studies that BRAC repeated a number of times also used both qualitative and quantitative methods (Mustafa *et al.*, 1996; Husain, 1998)

### 3 CONCLUDING THOUGHTS AND IMPLICATIONS FOR ACTION

The first and most obvious action point from these essays is that if we are to understand wider impact and, therefore, possibilities for more effective action by microfinance against poverty, a mechanism for incentivizing MFIs to be involved in assessments of such external effects is needed. That this will be difficult is indicated by Khalily, who writes bluntly that *even conventional impact assessments* (which examine only effects experienced by clients, and are much cheaper) are seen as 'donor-driven and useless from the point of view of practitioners'. *A fortiori*, the market will not produce assessments of social impact, because they are not profitable to any individual. And yet, we argue, such assessments are absolutely essential if any microfinance institution is to understand, or publicize, or learn from, its social impact, or if any sponsor is to properly understand the possibilities and comparative advantages of different instruments in the fight against poverty. Are these assessments just a classical 'public good', valuable to all but beyond the means of any individual institution, only to be produced by large charitable not-for-profit organizations such as the World Bank and the Ford Foundation? Encouragingly, the range of non-profit organizations which can and wish to produce or commission such assessments is expanding, and now includes many Southern not-for-profit organizations such as BRAC (the author or co-author of three studies in this collection). In addition, in many environments in both North and South the not-for-profit sector is growing at the expense of the commercial sector, and so the question becomes how to persuade larger parts of the voluntary sector to produce assessments such as this on a regular basis, so that they convert from one-off exercises into a process of social impact monitoring. In some places there is evidence of this beginning to happen, often through the agency of networks of voluntary-sector organisations. One place this is happening is Bolivia, and the article by Velasco and Marconi, in this issue, is the product of a co-authorship between the director of one such network (FINRURAL) and the director of a highly successful local MFI (ProMujer). In the end, progress in this area depends on NGOs being convinced that producing public goods of this kind is a useful way of advancing their corporate objectives. A bottleneck for MFIs to undertake impact assessments on a regular basis is lack of research capacities. Developing such capacities requires both commitments on the part of the organisations and long-term investments of resources. As many MFIs are simply not resourced enough to make such an investment, the donors have a definite role to play in supporting the provision of this sectoral (if not global) public good. BRAC in Bangladesh, for example, has been investing in developing its research capacities since its inception in the early 1970s. One innovative funding mechanism it followed is by earmarking a certain proportion (2 to 4 percent depending on the size of the project) of its budget for research (Strom, 2000).

A second important lesson is that *complementarities are crucial*, and that the size of wider social impacts is often determined by a crucial trait of institutional design or government policy. Two examples: (1) the poverty reduction impact of microfinance depends on the propensity of loan-assisted firms to take on low-income labour (the example of Uganda is illustrated in Mosley and Rock, this issue), which depends on wages and transactions costs in labour markets, which depend on complementary government policies such as infrastructure and smallholder agriculture. (2) the extraordinary growth and diversification of the microfinance and small business sector in Bolivia in the 1990s would not have been possible without the proactive efforts of the regulatory authority, the Superintendencia de Bancos, in enabling non-profit MFIs to convert themselves into deposit-taking institutions (Johnson, in this issue, also Rhyne, 2002).



Thirdly, *donor behaviour matters*, not least in creating these complementarities. Tsilikounas, this issue shows how the effectiveness of microfinance for reconstruction in Bosnia has been undermined by over-generous grant funding of investment by donors in the immediate postwar period, which has sapped the incentive both to take up and to repay loans: a classic moral hazard problem. But in many places a much happier synergy between donors and microfinance institutions has built up, not least in the nexus between evaluation and institutional reform: the reform of the BRI unit desa system from loss to profit in the mid 1980s, and the conversion of PRODEM into BancoSol in the early 1990s, were both the result of a happy synergy between the microfinance sector of Indonesia and Bolivia, respectively, and one particular donor (USAID). In both of these cases the profit motive was powerful. Now that many institutions inside and outside microfinance aspire to meet the criterion of a 'double bottom line'—both financial and social—will perceived underperformance in meeting social objectives cause the existing microfinance movement to put more effort into measuring wider social impacts, and thereby provide more effective escape routes out of poverty? It would be attractive to think that the Ford Foundation, through its sponsorship of the *Imp-Act* programme, had been instrumental in doing this.

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